

# CALIFORNIA STATE AUDITOR

## Bureau of State Audits

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### *Independent Auditor's Report*

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#### THE GOVERNOR AND THE LEGISLATURE OF THE STATE OF CALIFORNIA

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of and for the year ended June 30, 2007, which collectively comprise the State of California's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of California's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the following significant amounts in the financial statements of:

#### Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 82 percent, 42 percent, and 56 percent, respectively, of the assets, net assets, and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, Public Employees' Benefits, and certain other funds that, in the aggregate, represent over 99 percent of the assets, net assets, and revenues of the discretely presented component units.

#### Fund Financial Statements

- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 89 percent, 79 percent, and 88 percent, respectively, of the assets, net assets, and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System that, in the aggregate, represent 93 percent, 94 percent, and 75 percent, respectively, of the assets, net assets, and additions of the fiduciary funds and similar component units.
- The discretely presented component units noted above.

Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinions, insofar as they relate to the amounts included for those funds and entities, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing*

*Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, reports on the State's internal control structure and on its compliance with laws and regulations will be issued in our single audit report. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis, schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances, and related notes are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of California's basic financial statements. The combining financial statements and schedules listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections of this report have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements, and accordingly, we express no opinion on them.

BUREAU OF STATE AUDITS

A handwritten signature in black ink, reading "John F. Collins II". The signature is fluid and cursive, with a large, stylized "J" and "C".

JOHN F. COLLINS II, CPA  
Deputy State Auditor

March 3, 2008

### NOTE 3: DEPOSITS AND INVESTMENTS

The State Treasurer administers a single pooled investment program comprising both an internal investment pool and an external investment pool (the Local Agency Investment Fund). A single portfolio of investments exists, with all participants having an undivided interest in the portfolio. Both pools are administered in the same manner, as described below.

As required by generally accepted accounting principles, certain risk disclosures are included in this note to the extent that the risks exist at the date of the statement of net assets. Disclosure of the following risks are included:

*Interest Rate Risk* is the risk that the value of fixed-income securities will decline because of changing interest rates. The prices of fixed-income securities with longer time to maturity tend to be more sensitive to changes in interest rates than those with shorter durations.

*Credit Risk* is the risk that a debt issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline.

*Custodial Credit Risk* is the risk that, in the event a financial institution or counterparty fails, the investor will not be able to recover the value of deposits, investments, or collateral.

*Concentration of Credit Risk* is the risk of loss attributed to the magnitude of an investor's holdings in a single issuer.

*Foreign Currency Risk* is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

## A. Primary Government

The State's pooled investment program and certain funds of the primary government are allowed by state statutes, bond resolutions, and investment policy resolutions to invest in United States government securities, Federal agency securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, other debt securities, repurchase agreements, reverse repurchase agreements, and other investments.

Certain discretely presented component units participate in the State Treasurer's Office pooled investment program. As of June 30, 2007, the discretely presented component units accounted for approximately 3.2% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

Both deposits and investments are included in the State's investment program. For certain banks, the State Treasurer's Office maintains cash deposits that cover uncleared checks deposited in the State's accounts and that earn income which compensates the banks for their services.

Demand and time deposits held by financial institutions as of June 30, 2007, totaling approximately \$9.0 billion, were insured by federal depository insurance or by collateral held by the State Treasurer's Office or an agent of the State Treasurer's Office in the State's name. The California Government Code requires that collateral pledged for demand and time deposits be deposited with the State Treasurer.

As of June 30, 2007, the State Treasurer's Office had amounts on deposit with a fiscal agent totaling \$29 million related to principal and interest payments to bondholders. Additionally, \$6 million was in a compensating balance account with a custodial agent to provide sufficient earnings to cover fees for custodial services. These deposits were also insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of securities in the State Treasurer's pooled investment program generally is based on quoted market prices. As of June 30, 2007, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 138 days. Weighted average maturity is the average number of days, given a dollar-weighted value of individual investments, that the securities in the portfolio have remaining from evaluation date to stated maturity.

The Pooled Money Investment Board provides oversight of the State Treasurer's pooled investment program. The purpose of the board is to design an effective cash management and investment program, using all moneys flowing through the State Treasurer's Office bank accounts and keeping all available funds invested in a manner consistent with the goals of safety, liquidity, and yield. The Pooled Money Investment Board is comprised of the State Treasurer as chair, the State Controller, and the Director of Finance. This board designates the amounts of money available for investment. The State Treasurer is charged with making the

actual investment transactions for this program. This investment program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits in the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2007, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

Certain funds have elected to participate in the pooled investment program, even though they have the authority to make their own investments. Others may be required by legislation to participate in the program. As a result, the deposits of these funds or accounts may be considered involuntary. However, these funds or accounts are part of the State's reporting entity. The remaining participation in the pool, the Local Agency Investment Fund, is voluntary.

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. Instead, by law, the earnings are to be assigned to the State's General Fund. Some of the \$537 million in interest revenue received by the General Fund from the pooled investment program in the 2006-07 fiscal year was earned on balances in these funds.

The State Treasurer's pooled investment program values participants' shares on an amortized cost basis. Specifically, the program distributes income to participants quarterly, based on their relative participation during the quarter. This participation is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This amortized cost method differs from the fair value method used to value investments in these financial statements; the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair value of the pool's investments. Because the total difference between the fair value of the investments in the pool and the value distributed to pool participants using the amortized cost method described above is not material, no adjustment was made to the financial statements.

The State Treasurer's Office also reports participant fair value as a ratio of amortized cost on a quarterly basis. The State Treasurer's Office has not provided or obtained a legally binding guarantee to support the principal invested in the investment program.

As of June 30, 2007, structured notes and asset-backed securities comprised slightly less than 3.5% of the pooled investments. A significant portion of the asset-backed securities consists of small-business loans and mortgage-backed securities. The small-business loans held in the portfolio are guaranteed by the Small Business Administration, an agency of the federal government. The mortgage-backed securities, which are called real estate mortgage investment conduits (REMICs), are securities backed by pools of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule. A portion of the asset-backed securities consisted of floating-rate notes. For floating-rate notes held in the portfolio during the fiscal year, the interest received by the State Treasurer's pooled investment program rose or fell as the underlying index rate rose or fell. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio provided a hedge against the risk of increasing interest rates.

Enterprise funds and special revenue funds also make separate investments, which are presented at fair value.

Table 1 identifies the investment types that are authorized by the California Government Code and the State Treasurer's Office investment policy for the pooled investment program.

**Table 1**

**Authorized Investments**

<b>Authorized Investment Type</b>	<b>Maximum Maturity</b>	<b>Maximum Percentage of Portfolio</b>	<b>Maximum Investment in One Issuer</b>	<b>Credit Rating</b>
U.S. Treasury Securities	5 years*	N/A**	N/A**	N/A**
Federal Agency Securities	5 years*	N/A**	N/A**	N/A**
Certificates of Deposit	5 years*	N/A**	N/A**	N/A**
Bankers Acceptances	180 days*	N/A**	N/A**	N/A**
Commercial Paper	180 days	30%	10% of issuer's outstanding Commercial Paper	A-2/P-2/F-2***
Corporate Bonds/Notes	5 years*	N/A**	N/A**	A/A/A****
Repurchase Agreements	1 year*	N/A**	N/A**	N/A**
Reverse Repurchase Agreements	1 year*	10%*	N/A**	N/A**

\* Limitations are pursuant to the State Treasurer's Office Investment Policy for the Pooled Money Investment Account. The Government Code does not establish limits for investments of surplus moneys in this investment type.

\*\* N/A = Neither the Government Code nor the State Treasurer's Office Investment Policy for the Pooled Money Investment Account sets limits for the investment of surplus moneys in this investment type.

\*\*\* The State Treasurer's Office Investment Policy for the Pooled Money Investment account is more restrictive than the Government Code, which allows investments rated A-3/P-3/F-3.

\*\*\*\* The Government Code requires that a security fall within the top three ratings of a nationally recognized rating service.

## 1. Interest Rate Risk

Table 2 presents the interest rate risk of the primary government's investments.

**Table 2****Schedule of Investments – Primary Government – Interest Rate Risk**

June 30, 2007

(amounts in thousands)

	Interest Rates*	Maturity	Fair Value at Year End	Weighted Average Maturity ( in years)
<b>Pooled investments</b>				
U.S. Treasury bills and notes .....	4.77 - 4.97	12 days - 180 days	\$ 3,362,656	0.24
U.S. agency bonds and discount notes .....	3.01 - 5.64	6 days - 2.45 years	13,227,874	0.71
Small Business Administration loans .....	5.55 - 6.38	0.25 year	629,834	0.25 **
Mortgage-backed securities # .....	3.92 - 14.25	124 days - 8.13 years	840,984	3.88
Certificates of deposit .....	5.27 - 5.34	2 days - 180 days	15,594,616	0.18
Commercial paper .....	5.17 - 5.39	2 days - 121 days	14,471,657	0.11
Corporate bonds and notes .....	4.30 - 5.50	20 days - 2.33 years	1,683,796	0.40
<b>Total pooled investments .....</b>			<b>49,811,417 @</b>	
<b>Other primary government investments</b>				
U.S. Treasuries and agencies .....			1,996,805	4.71 ***
Commercial paper .....			868,963	N/A ****
Guaranteed investment contracts .....			602,683	14.14
Corporate debt securities .....			583,619	1.42
Other .....			996,057	0.57
<b>Total other primary government investments ^ .....</b>			<b>5,048,127</b>	
<b>Funds outside primary government included in pooled investments</b>				
Less: investment trust funds .....			19,990,748	
Less: other trust and agency funds .....			2,331,496	
Less: discretely presented component units .....			2,081,871	
<b>Total primary government investments .....</b>			<b>\$ 30,455,429</b>	

\* These numbers represent high and low interest rates for each investment type.

\*\* In calculating SBA holdings' weighted average maturity, the State Treasurer's Office assumes stated maturity is the quarterly reset date.

\*\*\* This amount includes \$495,000 of U.S. Treasuries and agencies securities held by the Golden State Tobacco Securitization Corporation that mature in less than one year.

\*\*\*\* These commercial paper holdings of the California State University and the Golden State Tobacco Securitization Corporation mature in less than one year.

# These securities are issued by U. S. government agencies such as the Federal National Mortgage Association.

@ Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include \$8.7 billion of time deposits and \$7.2 billion of loans to State funds, which are reported as cash in the respective funds.

^ Total other primary government investments include approximately \$22 million of cash equivalents that are included in Cash and Pooled Investments.

Table 3 identifies the debt securities that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously).

**Table 3**

**Schedule of Highly Sensitive Investments in Debt Securities – Primary Government – Interest Rate Risk**

June 30, 2007

(amounts in thousands)

	<b>Fair Value at Year End</b>	<b>% of Total Pooled Investments</b>
<b>Pooled investments</b>		
Mortgage-backed		
Federal National Mortgage Association Collateralized Mortgage Obligations .....	\$ 840,265	1.686 %
Government National Mortgage Association Pools .....	231	0.000
Federal Home Loan Mortgage Corporation Participation Certificate Pools .....	488	0.001

These mortgage-backed securities entitle the purchaser to receive a share of the cash flows, such as principal and interest payments, from a pool of mortgages. Mortgage securities are sensitive to interest rate changes because principal prepayments either increase (in a low interest rate environment) or decrease (in a high interest rate environment). A change, up or down, in the payment rate will result in a change in the security yield.



## 2. Credit Risk

Table 4 presents the credit risk of the primary government's debt securities.

**Table 4****Schedule of Investments in Debt Securities – Primary Government – Credit Risk**

June 30, 2007

(amounts in thousands)

Credit Rating as of Year End		
Short-term	Long-term	Fair Value
Pooled investments*		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 35,274,735 **
A-1/P-1/F-1	AA/Aa/AA	8,026,780
A-2/P-2/F-2	A/A/A	1,676,428
Not rated .....		840,753
Not applicable .....		3,992,721
Total pooled investments .....		\$ 49,811,417 ***
Other primary government investments		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 1,101,388
A-1/P-1/F-1	AA/Aa/AA	772,659
A-2/P-2/F-2	A/A/A	769,220
Not rated .....		549,548
Not applicable .....		1,855,312
Total other primary government investments		\$ 5,048,127

\* The State Treasurer's Office utilizes Standard & Poor's, Moody's, and Fitch ratings services. Securities are classified by the lowest rating of the three agencies.

\*\* This amount includes \$6.6 billion in Freddie Mac-issued debt. Freddie Mac has not requested that all of its debt be rated, but all debt that has been rated received S&P's and Moody's top ratings.

\*\*\* Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include time deposits of \$8.7 billion, for which credit risk is mitigated by collateral that the State holds for them—as discussed earlier in this note—and loans to State funds of \$7.2 billion, for which external credit risk is not applicable because they are internal loans.

### 3. Concentration of Credit Risk

The investment policy of the State Treasurer's Office contains no limitations on the amount that can be invested in any one issuer beyond those limitations stipulated in the California Government Code. Table 5 identifies debt securities in any one issuer (other than U.S. Treasury securities) that represent 5% or more of the State Treasurer's investments, or of the separate investments of other primary government funds.

**Table 5**

**Schedule of Investments – Primary Government – Concentration of Credit Risk**

June 30, 2007

(amounts in thousands)

**POOLED INVESTMENTS**

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>	<u>% of Total Pooled Investments</u>
Federal Home Loan Mortgage Corp.	U.S. agency securities	\$ 6,553,214	13.16 %
Federal Home Loan Bank	U.S. agency securities	5,831,586	11.71
Citigroup, Inc	Corporate Bonds/Commercial Paper	2,743,368	5.51
General Electric Capital/GE Company	Corporate Bonds/Commercial Paper	2,649,884	5.32

**OTHER PRIMARY GOVERNMENT INVESTMENTS**

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>	<u>% of Total Agency Investments</u>
<b>Golden State Tobacco Securitization Corporation</b>			
Coral	Commercial paper	\$ 58,378	12.39 %
Briarwood	Commercial paper	63,514	13.48
Morgan Stanley	Commercial paper	74,633	15.84
Security Benefit Life Insurance	Commercial paper	65,021	13.80
Curzon	Commercial paper	63,985	13.58
Chesham	Commercial paper	74,633	15.84
Natexis Banques Populaires	Commercial paper	65,870	13.98

**Department of Water Resources**

Federal Home Loan Mortgage Corp.	U.S. agency securities	\$ 50,722	41.61 %
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### 4. Custodial Credit Risk

The State of California has a deposit policy for custodial credit risk that requires deposits held by financial institutions to be insured by federal depository insurance or secured by collateral. As of June 30, 2007, \$24 million in deposits of the Electric Power Fund were uninsured and uncollateralized.

## B. Fiduciary Funds

The fiduciary funds include pension and other employee benefit trust funds of the following fiduciary funds and component units: the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), the fund for the California Scholarshare program, and various other funds. CalPERS and CalSTRS account for 98% of these separately invested funds.

CalPERS and CalSTRS exercise their authority under the State Constitution and invest in stocks, bonds, mortgages, real estate, and other investments.

CalPERS reports investments in securities at fair value, generally based on published market prices and quotations from major investment firms. Many factors are considered in arriving at fair value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Investments in certain restricted common stocks are valued at the quoted market price of the issuer's unrestricted common stock, less an appropriate discount.

CalPERS' mortgages are valued on the basis of their future principal and interest payments, discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, is estimated based on independent appraisals. Short-term investments are reported at market value, when available, or, when market value is not available, at cost plus accrued interest, which approximates market value. For investments where no readily ascertainable market value exists, management, in consultation with its investment advisors, determines the fair values for the individual investments.

Under the State Constitution and statutory provisions governing CalPERS' investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. CalPERS held for investment purposes futures and options with a fair value of approximately \$30 million as of June 30, 2007. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in fiduciary net assets.

Due to the level of risk associated with certain derivative investment securities, it is reasonably possible that investment securities values will change in the near term; such changes could materially affect the amounts reported in the financial statements.

CalPERS uses forward foreign currency exchange contracts primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2007, CalPERS had an approximately \$30 million net exposure to loss from forward foreign currency exchange transactions related to the approximately \$54.8 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

CalSTRS also reports investments at fair value, generally based on published market prices and quotations from major investment firms for securities. Mortgages are valued based on future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either recent estimates provided by CalSTRS' contract real estate advisors or by independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates

fair value. Fair value for commingled funds (other than those funds traded on a national or international exchange) is based on information provided by the applicable fund managers. Alternative investments represent interests in private equity partnerships that CalSTRS enters into under a limited partnership agreement. For alternative investments and other investments for which no readily ascertainable market value exists, CalSTRS management, in consultation with its investment advisors, has determined the fair value for the individual investments. Purchases and sales are recorded on the trade date.

The State Constitution, state statutes, and board policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third-party securities lending agents are under contract to lend domestic and international equity and debt securities. For both CalPERS and CalSTRS, collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively. CalPERS' management believes that CalPERS has minimized its credit risk exposure by requiring the borrowers to provide collateral greater than 100% of the market value of the securities loaned. The securities loaned are priced daily. Securities on loan can be recalled on demand by CalPERS and loans of securities may be terminated by CalPERS or the borrower.

For CalPERS, the weighted average maturities of the collateral invested by two externally managed portfolios and two internally managed portfolios were 46 days, 158 days, 547 days, and 410 days. In accordance with CalPERS' investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2007, had durations of 1 day, 18 days, 36 days, and 40 days, for two externally managed portfolios and two internally managed portfolios.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2007, had a 25-day difference in weighted average maturity between the investments and loans. Most of CalSTRS' security loans can be terminated on demand by CalSTRS or the borrower. As of June 30, 2007, CalSTRS has no credit risk exposure to borrowers because the amounts it owes the borrowers exceed the amounts the borrowers owe it. CalSTRS is not permitted to pledge or sell collateral securities received unless the borrower defaults. The contracts with the security lending agents require them to indemnify CalSTRS if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrowers fail to pay CalSTRS for income distributions by the securities' issuers while the securities are on loan.

Table 6 presents the investments of the fiduciary funds by investment type.

**Table 6**

**Schedule of Investments - Fiduciary Funds**

June 30, 2007

(amounts in thousands)

	<b>Fair Value</b>
<b>Investment Type</b>	
Equity securities .....	\$ 256,590,799
Debt securities* .....	101,817,056
Investment contracts .....	735,404
Mutual funds .....	7,761,185
Real estate .....	38,113,015
Insurance contracts .....	322,606
Private equity .....	29,456,424
Securities lending collateral .....	78,404,152
Other.....	1,203,057
<b>Total investments .....</b>	<b>\$ 514,403,698</b>

\* Debt securities include short-term investments not included in Cash and Pooled Investments.

## 1. Interest Rate Risk

CalPERS and CalSTRS manage the interest rate risk inherent in their investment portfolios by measuring the effective or option-adjusted duration of the portfolio. In using the duration method, these agencies may make assumptions regarding the timing of cash flows or other factors that affect interest rate risk information. The CalPERS investment policies require the option-adjusted duration of the total fixed-income portfolio to stay within 20% of the option adjusted duration of its benchmark (Lehman Brothers Long Liabilities). All individual portfolios are required to maintain a specific level of risk relative to their benchmark. Risk exposures are monitored daily. The CalSTRS investment guidelines allow the internally managed long-term investment grade portfolios the discretion to deviate within plus or minus .50 years from the effective duration of the relevant Lehman Brothers benchmark. The permissible range of deviation for the effective duration within the high yield portfolios is negotiated with each of the high yield managers and detailed in the investment guidelines. The CalSTRS investment guidelines state that 50% of the portfolio shall reflect an expected-maturity, first-call date or first-reset date to fall within a 0-30 day range and/or be invested in U.S. government and agency obligations.